No. 80-1000

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In the Supreme Court of the United States

OCTOBER TERM, 1980

SAMUEL G. PAYTE, PETITIONER

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

MEMORANDUM FOR THE UNITED STATES IN OPPOSITION

WADE H. MCCREE, JR.
Solicitor General
Department of Justice
Washington, D.C. 20534
(202) 633-2217

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Petitioner seeks review of the decision in this federal income tax case holding that interest paid on a loan incurred to purchase his deceased partner's partnership interest did not qualify for net operating loss carryback treatment because the underlying loan transaction was not attributable to his trade or business within the meaning of Section 172(d)(4) of the Internal Revenue Code of 1954 (26 U.S.C.).

1. The pertinent facts are as follows: In 1968, petitioner, a member of a three-man partnership, entered into a buy-sell agreement with his partners providing that the surviving partners would purchase a deceased partner's interest (Pet. App. 24). In 1969, one partner died, and the surviving partners, in accordance with the agreement, had the decedent's partnership interest appraised. They made a down payment of ten percent of the purchase price, executing a

six-year promissory note carrying interest at four percent per annum on the unpaid balance, payable to the trustee of the deceased partner's estate. In 1971, petitioner paid to the trustee $83,464, of which $24,038.64 was interest. On his 1971 income tax return, petitioner claimed the interest expense as an itemized deduction, and, treating the transaction as attributable to his trade or business, attempted to carry back the interest deduction not consumed in 1971 to 1968, reducing his tax liability for that earlier year. On audit, the Commissioner disallowed petitioner's claimed carryback loss and determined a deficiency (Pet. App. 25).

Petitioner paid the assessment and brought this suit for refund in the United States District Court for the Northern District of Texas. The district court upheld the Commissioner's disallowance on the ground that petitioner's acquisition of the partnership interest was not attributable to his trade or business, but was an acquisition of a capital asset (Pet. App. 31). The court of appeals affirmed *per curiam*, on the basis of the district court's opinion (Pet. App. 22-23).

2. The decision below correctly held that petitioner could not carry back the unused portion of his 1971 interest deduction to 1968. This case does not involve the deductibility of interest as such. Interest is deductible under Section 163 of the Code if paid or incurred on business or personal loans. This case arises, however, in the context of the net operating loss carryback. In 1971, petitioner's interest deductions exceeded his income, so that he would lose the benefit of that interest deduction unless it could be carried back to offset income of an earlier year. To qualify for carryback treatment under the net operating loss provision of Section 172(d)(4), the interest must be attributable to petitioner's trade or business; interest paid on a nonbusiness loan may not be carried back to a previous taxable year. The decision below correctly held that the interest, which was an integral part of the cost of acquiring the deceased

partner's share, was not attributable to petitioner's trade or business, but was attributable to the acquisition of a capital asset (Pet. App. 30-31). *United States* v. *Hilton Hotels Corp.*, 397 U.S. 580 (1970); & *Woodward* v. *Commissioner*, 397 U.S. 572 (1970). Petitioner's argument (Pet. 9-13) that his significant and/or dominant motivation in making the payment was to preserve the business from termination or forced sale is beside the point. In this context, petitioner was acting as an investor, which does not constitute a trade or business.

Axelrod v. *Commissioner*, 320 F 2d 327 (6th Cir. 1963), upon which petitioner relies (Pet. 15, 20), is distinguishable on its facts. In *Axelrod*, the court held that the phrase "trade or business" as used in Section 166(f) of the Code (dealing with bad debt losses arising from guarantees) was broad enough to cover the borrower's acquisition of a capital interest in a going partnership in order to preserve its existence. As the district court correctly noted (Pet. App. 27, 30), the decision in *Axelrod* turned on the fact that the taxpayer's purchase of the interest was essential to the preservation of the partnership because outside forces were directly threatening its survival. Here, on the other hand, the district court found that the survival of the partnership was not an issue. Moreover, petitioner's purchase of the interest was not essential to the preservation of the partnership. There was accordingly no trade or business nexus with that purchase.

At all events, the decision below is in accord with *United States* v. *Generes*, 405 U.S. 93 (1972), and *Whipple* v. *Commissioner*, 373 U.S. 193 (1963). *Generes* and *Whipple* each held that a loan made to a taxpayer to protect his investment is not one incurred in connection with his "trade or business" for purposes of a business bad debt deduction under Section 166(d)(2) of the Code. Under *Whipple*, decided two months prior to *Axelrod*, and *Generes*, there is

no basis for petitioner's claim that his purchase was part of his trade or business rather than his investment activities. To the extent *Axelrod* ignores the taxpayer's capital investment and turns on a taxpayer's perceived business preservation motive, it is inconsistent with *Whipple* and *Generes*. See also *United States* v. *Gilmore*, 372 U.S. 39 (1963).[1]

It is therefore respectfully submitted that the petition for a writ of certiorari should be denied.

WADE H. MCCREE, JR.
Solicitor General

FEBRUARY 1981

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[1]Finally, petitioner contends (Pet. 12-16) that his case involves a partnership and not a corporation so that his activities cannot be characterized as capital investment. But it is immaterial whether the business was conducted as a three-man partnership or three-man corporation. In either event, petitioner increased his capital interest, *i.e.*, investment in the business, whether he bought shares of a corporation or a partnership interest from the decedent's estate.